

Changes to auditor reporting standards in Canada: What to expect

April 2018

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Overview

The new and revised auditor reporting standards as published in the *CPA Canada Handbook – Assurance* become effective for audits of historical financial statements for periods ending on or after December 15, 2018, with earlier adoption permitted.

The Canadian Auditing Standards (CASs) are adopted from International Standards on Auditing (ISAs) with only limited amendments. The ISAs on which the new and revised Canadian auditor reporting standards are based became effective in December 2016 and were the most significant changes to auditor reporting under ISAs in decades. The changes to the CASs will result in a more meaningful auditor's report that your Grant Thornton audit team will issue starting in 2019.

Why now?

The auditor's report is the key deliverable upon the completion of an audit. The current auditor's report is basically a pass/fail approach and stakeholders, as well as other financial statement users, have long been asking for transparency on how the audit team draws their conclusions for the audit opinion. The new and revised auditor reporting standards will provide a more informative auditor's report via the inclusion of relevant information—such as better descriptions of what an audit is and auditor responsibilities—providing more insight to stakeholders.

What is changing?

The new reporting standards are not changing the scope of the audit. The focus is on increasing transparency around the results of the audit. The audit team has the primary responsibility of implementing the new requirements, but the changes are relevant to stakeholders as well.

There will be a new look to the auditor's report (see Appendix A below for an example of the form of the report). The revised standards require an increased focus on the auditor's role with

respect to entity-specific other information, as well as reporting of going concern matters. There is clarification of the roles of the auditor, management and now those charged with governance (when they are a separate body from management), leading to more robust interactions and communication among stakeholders, auditors and those charged with governance.

In conjunction with the updates to the existing auditor reporting standards, a new standard, CAS 701 *Communicating key audit matters in the independent auditor's report*, has been introduced. It is applicable either when key audit matters (KAMs) are required to be communicated by law or regulation, or if the auditor decides to communicate key audit matters in their report. The standard details the concept of key audit matters, which are matters that are most significant to the users' understanding of the audit. Currently, at an international level in the ISAs, the KAMs are required to be reported for listed entities (e.g., public companies). Canada is currently assessing the rollout of KAMs by other regulators before deciding on an implementation date for listed entities. Grant Thornton will continue to keep our clients up to date on any further Canadian-specific developments.

Finally, there are amendments to a number of other auditing standards so that the wording and requirements are consistent with changes introduced throughout CAS 700 and CAS 701.

Enhanced auditor's report

The most obvious change that stakeholders will notice as a result of the new and revised auditor reporting standards will be the form of the standard auditor's report. Some changes worth noting include:



The **auditor's opinion** is now at the very beginning of the auditor's report, changing the structure of the auditor's report.



The **basis of opinion** continues to describe the standards the audit was performed under (Canadian Auditing Standards), but now also includes an explicit statement regarding the auditor's independence according to the relevant ethical requirements in Canada.

The new auditor's report will include additional information:



A new separate section under the heading **"material uncertainty related to going concern"**, when a material uncertainty exists related to an entity's ability to continue as a going concern that must be adequately disclosed in the financial statements



Key audit matters will explain which items were of most significance to the audit, and will include a detailed description of the matter and a meaningful summary of how the matter was addressed *[when required by law or regulation or when the auditor decides to communicate]*



A new inclusion to cover the auditor's work conducted on **other information**, such as an annual report *[when other information has been obtained or is expected to be obtained]*



An enhanced description of **management's responsibilities** for assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate



Identification of **those charged with governance** and their responsibility for the oversight of the financial reporting process



An enhanced description of the **auditor's responsibilities**, including the responsibility to conclude on the appropriateness of management's use of the going concern basis of accounting



A new description of the auditor's **roles and responsibilities**, including the requirement to provide a statement to those charged with governance confirming that the auditor has complied with relevant ethical requirements regarding independence *[listed entities only]*



A new disclosure of the name of the engagement partner *[listed entities only]*

How will this impact management and those charged with governance?

As the auditor's report will now include enhanced disclosures around the auditor's responsibilities when there is a going concern issue, management and those charged with governance (including the audit committee)—along with your Grant Thornton auditor—need to have more robust and timely discussions on any matters which may bring into question the appropriateness of the going concern concept as early in the audit process as possible. This will allow the matter to be addressed without holding up the audit process. Management and those charged with governance need to consider if there are new conditions that the auditor may not be aware of that could result in a material uncertainty with respect to the entity's ability to continue as a going concern or a "close call" with respect to this assessment.

With the revised standards, the auditor's report will now communicate material inconsistencies noted from our review of other information. Management, those charged with governance and the audit committee, where applicable, will need to have timely discussions with their Grant Thornton auditor to determine what other information, if any, will need to be considered in scope for the audit. As in the past, the auditor is required to read other information and consider whether it is materially consistent with the audited financial statements. This other information

could be financial or non-financial information (consider management discussion and analysis, annual report, etc.). Due to the nature of other information and when it is obtained (before or after the date of the auditor's report), the wording of the other information paragraph will vary in the auditor's report depending on the circumstances. Timely discussions between the auditor, management and those charged with governance will allow for proper planning and review of such other information to allow for a suitable audit report date.

If key audit matters are included in the auditor's report, either because of a requirement by law or regulation or because the auditor chooses to disclose key audit matters, the audit team will discuss such matters with those charged with governance prior to issuing the report. The appearance of a KAM in the auditor's report does not eliminate management's responsibility to appropriately disclose items in the financial statements. Instead, it highlights the key focus areas of the audit and describes how such matters were dealt with.

In summary, the new auditor reporting standards will result in changes to your auditor's report. Increased variability in the composition and content of the auditor's report should be expected entity to entity, and possibly, year over year. Your Grant Thornton team is committed to navigating this standard as effectively and efficiently as possible. We will work with you to align expectations, proactively inform you of any changes in the nature and scope of the audit and discuss possible auditor's report implications in your specific situation. Should you want more details on this new standard, please reach out to your engagement partner at any time.

Appendix A – example of the new auditor's report

Independent Auditor's Report

[Appropriate Addressee]

Opinion

We have audited the financial statements of ABC Company ("the Company"), which comprise the balance sheet as at December 31, 20XX, and the statements of income, retained earnings and cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as at December 31, 20XX, and the results of its operations and its cash flows for the year then ended in accordance with the applicable financial reporting framework.¹

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Material Uncertainty Related to Going Concern

[when applicable – i.e., a material uncertainty exists related to the entity's ability to continue as a going concern]²

We draw attention to Note X in the financial statements, which indicates that the Company incurred a net loss of \$X during the year ended December 31, 20XX and, as at that date, the Company's current liabilities exceeded its total assets by \$X. As stated in Note X, these events or conditions, along with other matters as set forth in Note X, indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Other Information

[where applicable, such as for MD&A or annual reports]²

Management is responsible for the other information. The other information comprises the [information included in the X report, but does not include the financial statements and our auditor's report thereon.]

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the applicable financial reporting framework, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing these financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to a going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists,

we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

[listed entities only] We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

[listed entities only] The engagement partner on the audit resulting in this independent auditor's report is [name].

[Auditor's signature]
[Date of the auditor's report]
[Auditor's address]

Note: The key audit matters paragraph would be included where (i) required by law or regulation, or (ii) as decided by the auditor, and would be located between the going concern and other information paragraphs in the example above. The wording for the key audit matters paragraph is very entity-specific and will vary from client to client.

1 Examples of applicable financial reporting frameworks could include International Financial Reporting Standards (IFRS) or Accounting Standards for Private Enterprises (ASPE). Titles of the specific statements will vary by accounting framework.

2 Content in the going concern paragraph and other information paragraph will differ based on the company specific situation.



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